APPENDIX A

EFFECTIVE DATES AND TRANSITION RULES

Implementing the Treasury Department's reform proposal will involve a fundamental tradeoff. On the one hand, immediate implementation of the proposals would be desirable in order to capture as soon as possible the gains in equity, economic neutrality and simplicity described at length in this report; immediate implementation would also be the simplest policy, as it would avoid inevitably complex transition rules. On the other hand, immediate implementation of the proposals would be unfair and disruptive; taxpayers who made commitments based on the current tax structure would suffer unanticipated gains and losses when the tax law was changed suddenly. Such reform-induced windfall gains and losses amount to essentially arbitrary redistributions of income and are therefore an undesirable, if inevitable, consequence of reform. The magnitude of the gains and losses induced by implementation of the Treasury Department's proposal could be reduced by delaying or phasing-in implementation or by using "grandfathering" provisions which guarantee current tax treatment to taxpayers who made commitments based on current law.

The Treasury Department's proposal provides for a fair and orderly transition by striking a balance between the conflicting objectives of maximizing the equity, economic neutrality and simplicity gains of rapid implementation and minimizing the arbitrary redistributions of income induced by unexpected tax reform. All four of the implemetation options described above -- immediate coupled with grandfathering provisions, delayed, phased-in, and immediate -- are utilized toward this end. The proposed effective dates and transition rules for each element of the Treasury Department's proposal are summarized in Table A-1; the listing of proposed changes corresponds to those in Appendixes 5-A, 6-A, and 7-A. The proposed effective dates and transition rules assume that legislation is introduced in early 1985, and that the reform package is enacted on July 1, 1985 with a general effective date of January 1, 1986.

The proposed transition rules can be divided into four general categories. Detailed descriptions of the transition rules are provided in Volume II. The four general categories are summarized as follows.

(1) Immediate implementation with grandfathering. Where feasible, grandfathering provisions are effective in avoiding reform-induced windfall gains and losses. They have the effect of applying the new tax laws to new commitments but avoiding a change in the tax treatment of commitments made on the basis of current law. Elements of the proposal which provide for permanent grandfathering of existing

commitments include the new real economic depreciation rules, the elimination of the investment tax credit, the extension of the at risk rules, the elimination of a variety of special expensing and amortization rules and other subsidies, the taxation of certain life insurance and annuity income, the new treatment of insurance company loss reserves, changes in the treatment of irrevocable non-grantor trusts, and the unification of the estate and gift tax laws. Note that whenever grandfathering occurs, it will generally benefit taxpayers to qualify for such treatment. In order to prevent a flood of tax-motivated commitments made prior to the general enactment date, grandfathering frequently will be granted only to commitments made prior to the date legislation is introduced; note that such treatment is more generous than granting grandfathering only to commitments made prior to the announcement date of a proposal, as has sometimes occurred in the past.

Grandfathering can also be provided on a temporary basis, where the goal is to reduce the windfalls caused by reform, but to subject all commitments to the same tax treatment by some fixed point in time. This is the approach taken for reform in the area of fringe benefits, where the new rules will apply as contracts expire or, at the latest, by January 1, 1989; also, application of the new rules will be delayed for one year in the cases of the two largest fringe benefits, employer-provided health care and life insurance, in order to allow time for employers and insurance companies to adjust to the new tax law. Similarly, partnerships existing prior to the date legislation is introduced will not be subject to the new corporate-type taxation until January 1, 1990.

Treatment similar in spirit to temporary grandfathering is proposed in several areas where the proposal will eliminate unfair preferential tax treatment, but immediate implementation would result in a large one-time increase in income as previously tax-advantaged income is brought into the tax base. In these cases, the adverse effects of the one-time increase in income will be tempered by allowing the increase in income to be spread evenly over a fixed number of years for tax reporting purposes. This treatment is proposed for the elimination of special bad debt deductions and the deduction for additions to "protection against loss" accounts by property and casualty insurance companies, the restriction of the use of cash accounting, and the new rules for insurance policyholder loans.

(2) Delayed implementation. Delayed implementation of some of the Treasury Department's proposals is recommended for four reasons.

First, delay reduces the magnitude of reform-induced redistributions by postponing the change in tax liability and by allowing time for existing commitments to expire. For these reasons, interest indexing will be postponed until January 1, 1988, and capital gains indexing (on non-depreciable assets) will be postponed until January 1, 1989.

Second, delay allows time for rebudgeting in cases where the elimination of preferential tax treatment should be offset by appropriate increases in Federal, state or local expenditures. For this reason, the changes in the taxation of military compensation and of unemployment and workers' compensation will be delayed until January 1, 1987.

Third, delay allows time for adjustment to new rules. Many of the changes in the taxation of estates will be delayed for one year in order to allow estate planners time to adjust to the new rules. Similarly, the replacement of the possessions tax credit with a wage credit will be delayed for one year to allow businesses time to adjust to the new tax structure.

Fourth, repeal of the individual and corporate minimum taxes -- subject to full implementation of the reform proposal -- will be delayed until January 1, 1990 in order to subject to taxation existing preferences which are grandfathered.

(3) Phased-in implementation. Phasing-in implementation is recommended for several elements of the Treasury Department reform package. Since phasing-in involves a modified form of delayed enactment, it not only has the advantage of reducing the magnitude of reform-induced redistributions, but also the further advantage of capturing some of the equity and economic neutrality gains from reform immediately. Phasing-in is recommended for the dividend relief proposal, the elimination of the itemized deduction for state and local taxes, the new limit on charitable contributions, the elimination of graduated corporate tax rates, the extension of the limit on interest deductions, and the denial of business deductions for entertainment expenses and meal costs in excess of a limit.

(4) Immediate implementation. In many cases, the Treasury Department's reform proposals can be implemented immediately with little effect on existing commitments. The changes in the zero bracket amount, personal exemptions, and a variety of credits and deductions fall into this category; the changes in individual and corporate rates will be delayed for six months solely to achieve the goal of revenue neutrality in the initial year after enactment. Similarly, the extension of Individual Retirement Accounts and the new rules on pension distributions will be implemented immediately.

Another class of proposals where reform should be implemented immediately are those involving provisions that are particularly objectionable in terms of violating equity principles. These include some changes in trust rules, limits on deductions for business expenses away from home, and highly preferential special rules for life and property and casualty insurance companies. Similarly, in view of the strong equity and neutrality arguments for elimination of the special preferences for the energy and natural resource industries, the Treasury Department proposes that these preferences be repealed immediately; to reduce the impact of immediate implementation on the energy industry, the repeal of the windfall profits tax will be accelerated by three years, with the scheduled three-year phase-out beginning on January 1, 1988 instead of January 1, 1991.

Table A-1

EFFECTIVE DATES AND TRANSITION RULES

Proposed Changes	Effective Dates and Transition Rules	
I. INCOME TAX REFORM AND SIMPLIFICATION FOR INDIVIDUALS		
A. Rate Reduction		
1. Reduce rates and collapse present 15 tax rates for single taxpayers and 14 tax rates for married taxpayers and heads of households into 3 rates.	7-1-86	delay designed to achieve revenue neutrality in initial year
B. Fairness for Families		
1. Increase the Zero Bracket Amount from $2,510 to $2,800 for single filers, from $2,510 to $3,500 for heads of households, and from $3,710 to $3,800 for joint filers.	1-1-86	
2. Increase personal exemptions from $1,090 to $2,000.	1-1-86	
3. Fold additional exemptions for the blind and elderly into an expanded credit for the elderly and disabled, and make all taxable disability income eligible for the credit.	1-1-86	
4. Repeal deduction for two-earner married couples.	1-1-86	
5. Index Earned Income Tax Credit.	1-1-86	
6. Replace child and dependent care credit with a deduction from gross income with same cap ($2,400 if one child, $4,800 if two or more).	1-1-86	
C. Fair and Neutral Taxation		
1. Excluded Sources of Income		
a. Fringe Benefits		
1. Repeal exclusion of health insurance above a cap ($175 per month for family coverage, $70 per month for individual coverage).	1-1-87	for contracts after date legislation is introduced;
	1-1-89	or expiration date (if earlier) for contracts existing prior to date legislation is introduced; delay allows time for adjustment to new rules
2. Repeal exclusion of group-term life insurance.	1-1-87	for contracts after date legislation is introduced;
	1-1-89	or expiration date (if earlier) for contracts existing prior to date legislation is introduced; delay allows time for adjustment to new rules

Proposed Changes	Effective Dates and Transition Rules
3. Repeal exclusion of employer-provided death benefits.	1-1-86 for contracts after date legislation is introduced; 1-1-89 or expiration date (if earlier) for contracts existing prior to date legislation is introduced
4. Repeal exclusion of dependent care services or reimbursement.	1-1-86 for contracts after date legislation is introduced; 1-1-89 or expiration date (if earlier) for contracts existing prior to date legislation is introduced
5. Repeal special treatment of cafeteria plans.	1-1-86 for contracts after date legislation is introduced; 1-1-89 or expiration date (if earlier) for contracts existing prior to date legislation is introduced
6. Repeal exemption of voluntary employee's beneficiary associations and trusts for supplemental unemployment compensation and black lung disability.	1-1-86 for income earned after 1-1-86
7. Repeal special treatment of incentive stock options.	1-1-86 for all options granted after date legislation is introduced; permanent grandfathering for options granted prior to date legislation is introduced
8. Tighten exclusion of employee awards.	1-1-86
9. Repeal exclusion of certain military compensation, with offsetting adjustments in military pay schedules.	1-1-87 delay allows time for offsetting change in expenditures
10. Repeal exclusion of rental allowances or rental value of a minister's home.	1-1-87 delay allows time for adjustment to new rules
b. Wage Replacement Payments	
1. Repeal tax-exempt threshold for unemployment insurance compensation.	1-1-87 delay allows time for offsetting change in state expenditures
2. Repeal tax exemption of workers' compensation, blacklung, and certain veterans' disability payments, but make all such income eligible for the credit for the elderly, blind, and disabled.	1-1-87 for all payments except workers' compensation for injuries prior to 1-1-87; delay allows time for offsetting changes in state and federal expenditures; permanent grandfathering for workers' compensation for injuries prior to 1-1-87
c. Other Excluded Sources of Income	
1. Repeal exclusion of scholarships and fellowships in excess of tuition.	1-1-86 for awards after 1-1-86; grandfathering up to four years for awards prior to 1-1-86
2. Repeal exclusion of awards and prizes.	1-1-86
2. Preferred Uses of Income	
a. Repeal the itemized deduction for state and local taxes.	1-1-86 Phase-in -- 50% deduction for 1 year, complete repeal by 1-1-87
b. Repeal the above-the-line deduction for charitable contributions.	1-1-86 (scheduled expiration date is 1-1-87)
c. Limit itemized deductions for charitable contributions to those in excess of 2 percent of gross income.	1-1-86 Phase-In -- 1% limit for 1 year; full enactment by 1-1-87

Proposed Changes	Effective Dates and Transition Rules	
d. Limit deduction for charitable contributions of appreciated property to indexed basis.	1-1-86	
e. Repeal 50% and 30% limits on individual contributions.	1-1-86	
f. Repeal 10% limit on corporate contributions (but retain 5% limit in certain cases).	1-1-86	
D. <u>Tax Abuses</u>		
1. Business Deductions for Personal Expenses		
a. Deny all entertainment expenses including club dues and tickets to public events, except for business meals furnished in a clear business setting. Limit deduction for business meals on a per meal per person basis.	1-1-86	Phase-In -- allow 50% deduction (in excess of meal limit) for 1 year; full enactment by 1-1-87
b. Limit deductions for meals and lodging away from home in excess of 200 percent of the Federal per diem. When travel lasts longer than 30 days in one city, limit deductions to 150 percent of the Federal per diem.	1-1-86	
c. Establish bright-line rules to separate indefinite and temporary assignments at one year.	1-1-86	
d. Deny any deduction for travel as a form of education.	1-1-86	
e. Deny deductions for seminars held aboard cruise ships.	1-1-86	
f. Deny any deduction for travel by ocean liner, cruise ship, or other form of luxury water transportation above the cost of otherwise available business transportation with medical exception.	1-1-86	
2. Income Shifting		
a. Revise grantor trust rules to eliminate shifting of income to lower rate beneficiaries through trusts in which the creator retains an interest.	1-1-86	
b. During creator's lifetime, tax trusts at the creator's tax rate and allow deductions only for non-discretionary distributions and set-asides. After creator's death, tax all undistributed trust or estate income at the top marginal rate.	1-1-86	for irrevocable grantor trusts and all irrevocable trusts created after date legislation is introduced; irrevocable non-grantor trusts created prior to date legislation is introduced would be subject to rules applicable after creator's death
c. Tax unearned income of children under 14 at the parents' rate (to the extent such income exceeds the child's personal exemption).	1-1-86	
d. Revise income taxation of trusts.	1-1-86	for estates of decedents dying after 1-1-86

Proposed Changes		Effective Dates and Transition Rules
E. Further Simplification		
1. Non-filing system, in which IRS would compute taxes for many tax payers.	1-1-86	legislation effective; implementation date open
2. Repeal individual minimum taxes (only if basic reforms are fully implemented).	1-1-90	delay allows time to tax current preferences which are grandfathered
3. Move miscellaneous deductions above the line, combine with employee business expenses, and make subject to a floor.	1-1-86	
4. Repeal preferential treatment of capital gains.		(transition rule specified under II)
5. Repeal political contribution credit.	1-1-86	
6. Repeal presidential campaign checkoff.	1-1-86	
7. Repeal deduction of adoption expenses for children with special needs, and replace with a direct expenditure program.	1-1-87	delay allows time for offsetting change in expenditures
8. Disallow income averaging for taxpayers who were full-time students during the base period.	1-1-86	
9. Repeal $100/$200 exclusion for dividend income.	1-1-86	
F. Other Miscellaneous Reforms		
1. Increase limits on moving expenses.	1-1-86	
2. Special rule for allowing deduction of some commuting expenses by workers (e.g., construction workers) who have no regular place of work.	1-1-86	
II. BASIC TAXATION OF CAPITAL AND BUSINESS INCOME		
A. Lower Corporate Tax Rates		
1. Reduce maximum corporate rate to 33%.	7-1-86	
2. Repeal graduated corporate rate structure.	7-1-86	for corporations formed after date legislation is introduced; for corporations formed prior to date legislation is introduced, phase-in one-half of rate increase to maximum corporate rate in 7-1-86, with all corporations facing same tax rate by 1-1-87
3. Repeal personal holding company tax.	1-1-87	delay until phased-in of repeal of graduated corporate rate structure is complete

Proposed Changes	Effective Dates and Transition Rules	
B. Taxing Real Economic Income		
1. Index basis (cost) of assets and tax real gains as ordinary income.	1-1-86	for all assets purchased after 1-1-86;
	1-1-89	for non-depreciable assets purchased prior to 1-1-86; certain assets not subject to indexing (including depreciable assets purchased prior to 1-1-86 and non-depreciable assets purchased prior to 1-1-86 and sold between 1-1-86 and 1-1-89) will receive a capital gains exclusion rate set so that the maximum effective rate on total gains equals 20 percent (also, recapture rules will eventually be repealed)
2. Index depreciation for inflation and set depreciation allowances to approximate economic depreciation.	1-1-86	for assets purchased after 1-1-86; permanent grandfathering for assets purchased prior to 1-1-86
3. Repeal investment tax credit.	1-1-86	for investments made after 1-1-86; investments made prior to 1-1-86 receive full credit
4. Repeal collapsible corporation rules.	1-1-89	delay until taxation of indexed capital gains at ordinary income rates begins
5. Allow expensing of the first $5,000 of depreciable business property, but repeal currently scheduled increases in that dollar limit.	1-1-86	
6. Allow indexed FIFO and repeal LIFO conformity requirement.	1-1-86	
7. Index interest receipts and payments in excess of mortgage interest plus $5,000.	1-1-88	delay mitigates effects on lenders and borrowers in existing loans
C. Retirement Savings		
1. Raise IRA limits to $2,500.	1-1-86	
2. Make IRA's available to both employees and spouses working in the home.	1-1-86	
3. Subject all tax-favored retirement plans to uniform distribution rules.		
a. Subject all pre-retirement distributions from tax-favored retirement plans to a 20 percent premature distributions tax generally, (but 10 percent if used for tuition or first-home purchase).	1-1-86	

Proposed Changes	Effective Dates and Transition Rules	
b. Subject all tax-favored retirement plans to uniform minimum distribution rules.	1-1-86	
c. Repeal 10-year averaging for lump-sum distributions.	1-1-86	
d. Eliminate special recovery rules for qualified plan distributions.	1-1-86	
e. Repeal special treatment for distributions of employer securities.	1-1-86	
4. Simplify the deduction, contribution, and benefit limits for tax-favored retirement plans.		
a. Repeal aggregate-based deduction limit for profit-sharing and stock bonus plans.	1-1-86	
b. Subject excess contributions to a 6 percent excise tax to recapture excessive tax benefits.	1-1-86	
c. Repeal combined plan limit for non-top-heavy plans.	1-1-86	
d. Subject all distributions in excess of $112,500 per year to a 10 percent excise tax.	1-1-86	
5. Miscellaneous changes.		
a. Extend deduction limits for tax-favored retirement plans to employee stock ownership plans, and repeal the employee stock ownership plan credit.	1-1-86	
b. Repeal "cash or deferred arrangements."	1-1-86	
c. Subject reversions of funds from tax-favored retirement plans to employers to a 10 percent excise tax.	1-1-86	
D. <u>Neutrality Toward the Form of Business Organization</u>		
1. Reduce double taxation of distributed corporate earnings by allowing 50% dividend paid deduction. (Allow 50% dividends-received deduction for intercorporate dividends).	1-1-87	Phase-In -- 25% deduction for 1 year, with increases of 5% per year to 50% deduction by 1-1-92 (with matching reductions for corporate dividends-received deduction); permanent grandfathering for preferred stock issued prior to 1-1-87
2. Repeal $100/$200 exclusion of dividend income.	1-1-86	
3. Require that all limited partnerships with more than 35 limited partners be taxed as corporations.	1-1-86	for partnerships formed after date legislation is introduced;
	1-1-90	for partnerships existing prior to date legislation is introduced

Proposed Changes		Effective Dates and Transition Rules
III. INDUSTRY-SPECIFIC SUBSIDIES, TAX SHELTERS AND OTHER TAX ISSUES		
A. General Issues of Income Measurement		
1. Match expenses and receipts from multiperiod production.	1-1-86	for costs incurred on long-term contracts after 1-1-86 and self-constructed assets built after 1-1-86, with 10 year phase-in for existing timber and with income increase for inventory change spread evenly over 6 years
2. Restrict use of cash accounting method.	1-1-86	with income increase due to change spread evenly over 6 years
3. Limit bad debt deductions to actual loan losses.	1-1-86	with income increase due to change spread evenly over 10 years
4. Disallow installment sales treatment when receivables are pledged.	1-1-86	for new pledges; pledges existing prior to 1-1-86 would be subject to new rules 1-1-91
5. Repeal corporate minimum tax (only if basic reforms are fully implemented).	1-1-90	delay allows time to tax current preferences which are grandfathered
B. Subsidies for Specific Industries.		
1. Energy and Natural Resource Subsidies		
a. Repeal windfall profits tax.	1-1-88	move forward 3 years phase-out currently scheduled to begin on 1-1-91; complete repeal by 1-1-91 (instead of currently scheduled 1-1-94)
b. Repeal percentage depletion; use cost depletion, adjusted for inflation.	1-1-86	
c. Repeal expensing of intangible drilling costs.	1-1-86	
d. Repeal expensing of qualified tertiary injectant expenses.	1-1-86	
e. Repeal expensing of hard mineral exploration and development costs.	1-1-86	
f. Repeal special treatment of royalty income.	1-1-86	
g. Repeal special rules for mining reclamation reserves.	1-1-86	
h. Repeal non-conventional fuel production tax credit, alchohol fuels credit and excise tax exemption.	1-1-86	except for legislated exceptions regarding fuel from plants completed by 1-1-86
2. Special Rules of Financial Institutions		
a. Commercial banks and thrift institutions		
1. Repeal special bad debt deductions for banks and thrift institutions.	1-1-86	with income increase due to change spread evenly over 10 years
2. Disallow 100% of interest incurred to carry tax-exempt bonds by depository institutions.	1-1-86	for bonds acquired after 1-1-86; permanent grandfathering for bonds acquired prior to 1-1-86

Proposed Changes	Effective Dates and Transition Rules	
3. Repeal tax exemption of credit unions.	1-1-86	
4. Repeal special carryover rules, and repeal special merger rules for thrift institutions.	1-1-86	
b. Life Insurance Companies		
1. Limit life insurance reserve deductions to the increase in policyholders' cash surrender value.	1-1-86	for policies issued after 1-1-86; permanent grandfathering for policies issued prior to 1-1-86
2. Repeal special deduction of percentage of taxable income of life insurance companies.	1-1-86	
3. Repeal tax exemption for certain insurance companies.	1-1-86	
c. Property and Casualty (P&C) Insurance Companies		
1. Limit P&C reserves to the discounted present value of future liabilities.	1-1-86	for reserves acquired after 1-1-86; no recapture on reserves acquired prior to 1-1-86
2. Repeal mutual P&C insurance companies' deduction for additions to protection against loss account.	1-1-86	for policies issued after 1-1-86; income increase due to new rules (including existing "permanently deferred" amounts in income) would be spread evenly over 6 years.
3. Limit deductibility of P&C policyholder dividends.	1-1-86	
4. Repeal special tax exemption, rate reductions, and deductions of small mutual P&C insurance companies.	1-1-86	
3. Insurance Investment Income		
a. Repeal exclusion of investment income on life insurance policies.	1-1-86	for income earned after 1-1-86;
b. Treat policyholder loans as coming first from any tax-exempt inside buildup.	1-1-86	for loans made after 1-1-86; loans existing prior to 1-1-86 would be subject to new rules 1-1-91
c. Repeal exclusion of current annuity income.	1-1-86	for income earned after 1-1-86;
4. State and Local Government Debt and Investments		
a. Repeal the tax exemption of nongovernmental purpose tax-exempt bonds.	1-1-86	for bonds issued after 1-1-86, but allow refinancing of existing obligations with no extension of maturity
b. Tighten restrictions on tax arbitrage and advance refunding for tax-exempt bonds.	1-1-86	for bonds issued after 1-1-86, including refundings
5. Special Expensing and Amortization Rules		
a. Repeal expensing of soil and water conservation expenditures, expenditures by farmers for fertilizer and for clearing fields.	1-1-86	for contracts after date legislation is introduced; permanent grandfathering for contracts prior to date legislation is introduced

Proposed Changes		Effective Dates and Transition Rules
b. Repeal 5-year amortization of expenditures for rehabilitation of low income rental housing.	1-1-86	for contracts after date legislation is introduced; permanent grandfathering for contracts prior to date legislation is introduced
c. Repeal 5-year amortization of certified pollution control facilities.	1-1-86	for contracts after date legislation is introduced; permanent grandfathering for contracts prior to date legislation is introduced
d. Repeal 50-year amortization of railroad grading and tunnel bores.	1-1-86	for contracts after date legislation is introduced; permanent grandfathering for contracts prior to date legislation is introduced
e. Repeal 5-year amortization of trademark expenses.	1-1-86	for contracts after date legislation is introduced; permanent grandfathering for contracts prior to date legislation is introduced
f. Repeal 84-month amortization of reforestation expenditures and 10% tax credit for such expenditures.	1-1-86	for contracts after date legislation is introduced; permanent grandfathering for contracts prior to date legislation is introduced
6. Other Specific Subsidies		
a. Repeal rehabilitation tax credits.	1-1-86	for leases signed after date legislation is introduced; permanent grandfathering for leases signed prior to date legislation is introduced
b. Repeal special rules for returns of magazines and paperback books and for qualified discount coupons.		effective year of enactment, with balances of suspense accounts existing prior to enactment deductible in the year of enactment
c. Repeal exclusion relating to Merchant Marine Capital Constuction Fund.	1-1-86	for income earned after 1-1-86 with no tax-free contributions after date legislation is introduced; special rules for withdrawals between 1-1-86 and 1-1-96 with funds remaining on 1-1-96 treated as withdrawn at that time
d. Rationalize credit for research and experimentation.	1-1-86	for all research and experimentation after date legislation is introduced
C. Further Curtailment of Tax Shelters		
1. Disallow most current interest deductions (with carryforward) in excess of the sum of mortgage interest on the taxpayer's principal residence, investment income, income from limited partnerships and S corporations, and $5,000.	1-1-86	Phase-In -- use new netting rules with existing $10,000 limit for 2 years; drop limit to $5,000 beginning 1-1-88
2. Extend at risk limitations to real estate and equipment leasing.	1-1-86	for sales and leases after date legislation is introduced; permanent grandfathering for sales and leases prior to date legislation is introduced

Proposed Changes	Effective Dates and Transition Rules	
D. International Issues		
1. Change foreign tax credit limitation to a separate per country limitation.	1-1-86	excess foreign tax credits accumulated prior to 1-1-86 carried forward up to 5 years; losses occurring prior to 1-1-86 recaptured until exhausted
2. Modify rules defining source of income derived from sales of inventory-type property and intangible property.	1-1-86	for all sales after date legislation is introduced; permanent grandfathering for sales contracted prior to date legislation is introduced
3. Repeal the secondary dividend rule and replace with a branch profits tax.	1-1-86	
4. Repeal special preference for 80/20 corporations.	1-1-86	for all interest paid on obligations incurred after date legislation is introduced; permanent grandfathering for interest paid on obligations incurred prior to date legislation is introduced
5. Repeal possessions tax credit and replace with a phased out wage credit.	1-1-87	delay allows time for adjustment to new wage credit
6. Clarify treatment of certain transactions in foreign currency.	1-1-86	for all transactions after enactment; option to elect grandfathering on hedging contracts open as of 1-1-86
E. Other Tax Issues		
1. Transfer Taxation		
a. Unify estate and gift tax structure by grossing up the tax on gifts, and simplify rules for determining when a transfer is complete for gift tax purposes.	1-1-86	with special treatment for gifts transferred prior to 1-1-86
b. Simplify taxation of generation-skipping transfers, and modify credit for tax on prior transfers to a lower generation.		new generation skipping transfer rules apply to transfers made after enactment with exception of transfers made under wills or revocable trusts of decedents dying before one year after enactment date; new tax credit rules apply to estates of decedents dying one year after enactment date; delay allows time for adjustment to new rules
c. Impose a rule to prevent abuse of minority discounts.		new rules apply to transfers occurring and decedents dying after enactment date; special rules would apply to fractional transfers made prior to enactment date

Proposed Changes	Effective Dates and Transition Rules	
d. Replace the rules governing payment of estate tax in installments with simplified rules based on estate liquidity, but make interest incurred by an estate non-deductible for estate tax purposes.	1-1-86	
e. Reduce estate tax deduction for claims against an estate by the amount of income tax savings from payment of the expense.	1-1-86	for decedents dying after 1-1-86; for decedents dying prior to 1-1-86, new rules would apply to income recognized and deductions paid after 1-1-87
f. Simplify state death tax credit by making it a flat percentage of federal estate tax collected.		new rules apply to decedents dying one year after enactment date
g. Repeal special tax rules for redemption of stock to pay death taxes.	1-1-86	for decedents dying after 1-1-86, except for one year delay to 1-1-87 for redemptions pursuant to agreements binding on 1-1-86
h. Tighten rules regarding powers of appointment.	1-1-86	
2. Penalties		
a. Simplify information return penalties.	1-1-86	
b. Repeal maximum limits on penalties.	1-1-86	
c. Replace failure-to-pay penalty with a cost of collection charge.	1-1-86	
3. Expiring Provisions		
a. Residential and certain business energy tax credits.	1-1-86	with unused credits carried forward
b. Targeted jobs tax credit.	1-1-88	
c. Expensing of expenditures to remove architectural barriers to the elderly and handicapped.	1-1-86	
d. Credit for testing orphan drugs.	1-1-88	
e. Special treatment for dividend reinvestment in public utility stock.	1-1-86	
f. Exclusion of employer-provided legal services.	1-1-86	
g. Exclusion of employer-provided educational assistance.	1-1-86	
h. Exclusion of employer-provided van-pooling.	1-1-86	

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Fundamental Tax Reform
Change in Receipts by Source

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
INCOME TAX REFORM AND SIMPLIFICATION FOR INDIVIDUALS 1/					
A. Rate Reduction					
Rate schedules (see Note B at end of table).................	-33,824	-92,696	-106,710	-118,197	-132,093
B. Fairness for Families					
Increase the Zero Bracket Amount............................	2/	2/	2/	2/	2/
Increase personal exemptions................................	2/	2/	2/	2/	2/
Fold exemptions for the blind and elderly into an expanded credit for the elderly and disabled, make all taxable disability income eligible..............................	-56	-372	-354	-335	-319
Repeal second earner deduction..............................	2/	2/	2/	2/	2/
Index earned income tax credit..............................	-7	-215	-380	-498	-578
Replace child and dependent care credit with a deduction from gross income................................	-25	-254	-280	-303	-328
Fairness to Families, subtotal..............................	-88	-841	-1,014	-1,136	-1,224
C. Fair and Neutral Taxation					
Excluded Sources of Income:					
Limit exclusion of health insurance.........................	--	4,648	8,012	9,835	11,870
Repeal exclusion of group term life insurance...............	--	1,592	2,551	2,819	3,044
Repeal exclusion of employer provided death benefits........	7	49	49	49	49
Repeal exclusion of dependent care services.................	4	6	7	8	10
Repeal special treatment of cafeteria plans.................	196	709	1,645	2,713	3,218
Repeal exemption of VEBAs, supplementary unemployment trusts, and black lung disability trusts......	157	419	457	483	540
Repeal exclusion of employee awards.........................	*	*	*	*	*
Repeal exclusion of certain military pay....................	3/	3/	3/	3/	3/
Repeal exclusion of parsonage allowances....................	--	50	152	160	164
Repeal tax exempt threshold for unemployment compensation...	--	531	1,466	1,404	1,313
Repeal exclusion of workers' compensation (net of credit)...	--	218	1,515	1,895	2,093
Repeal exclusion of veterans' service disability compensation (net of credit).............................	--	919	1,475	1,538	1,603
Limit exclusion of scholarships and fellowships.............	30	202	207	213	219
Repeal exclusion of prizes and awards.......................	*	*	*	*	*
Excluded Sources of Income, subtotal........................	394	9,343	17,536	21,118	24,122
Preferred Uses of Income:					
Repeal deduction for state and local taxes..................	2,378	18,631	33,862	35,685	38,683
Repeal above-the-line charitable contributions deduction....	419	2,687	--	--	--
Limit charitable contribution deductions (2% income floor)..	982	4,209	5,782	6,245	6,744
Limit charitable deduction for appreciated property.........	62	211	232	255	281
Repeal 50% & 30% individual charitable contribution limits..	-70	-241	-265	-291	-321
Repeal 10% corporate charitable contribution limit Corporate...	-30	-63	-70	-77	-84
Preferred Uses of Income, subtotal:					
Individual..	3,771	25,497	39,611	41,894	45,387
Corporate...	-30	-63	-70	-77	-84

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
D. Tax Abuses					
Restrict entertainment expense deductions and limit deduction for business meals					
Individual	170	551	645	695	746
Corporate	448	887	1,028	1,110	1,191
Limit deduction for meals and lodging away from home					
Individual	41	72	78	84	90
Corporate	16	24	26	28	30
Limit temporary assignments to 1 year					
Individual	13	19	20	22	24
Require allocation of travel expenses					
Individual	18	138	149	161	174
Corporate	27	47	51	56	60
Deny deduction for education travel					
Individual	13	18	18	18	18
Corporate	*	*	*	*	*
Deny deduction for cruise ship seminars					
Individual	1	4	4	4	4
Corporate	*	*	*	*	*
Limit deduction for luxury water travel					
Individual	1	4	4	4	4
Corporate	*	*	*	*	*
Tighten grantor trust rules					
Individual	3	12	16	20	25
Revise taxation of trusts					
Individual	271	848	933	1,025	1,129
Tax unearned income of children under 14 at parent's rate					
Individual	149	462	509	559	615
Tax abuses, subtotal:					
Individual	679	2,128	2,376	2,593	2,828
Corporate	491	958	1,105	1,194	1,281
E. Further Simplification					
IRS non-filing system	--	--	--	--	--
Repeal individual minimum taxes	--	--	--	--	4/
Move miscellaneous deductions above the line and combine employee business expense	215	1,452	1,568	1,694	1,830
Repeal political contribution credit	*	301	309	331	353
Repeal presidential campaign checkoff	--	--	--	--	--
Repeal deduction for adoption expenses	3/	3/	3/	3/	3/
Disallow income averaging for full time students	133	541	589	637	687
Simplification, subtotal	348	2,294	2,466	2,662	2,870
F. Other Miscellaneous Reforms					
Increase limits on moving expenses	-40	-408	-449	-494	-543
Allow some commuting deductions if regular place of work	-18	-119	-122	-134	-138
Other Miscellaneous, subtotal	-58	-527	-571	-628	-681

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
BASIC TAXATION OF CAPITAL AND BUSINESS INCOME					
A. Reduce Corporate Tax Rates					
Reduce maximum corporate rate to 33%					
Corporate	-12,549	-35,343	-46,454	-51,039	-58,393
Repeal graduated corporate rate structure					
Corporate	1,629	5,966	7,924	7,793	7,868
Repeal personal holding company tax					
Corporate	--	--	--	--	--
Reduce corporate tax rates, subtotal:					
Corporate	-10,920	-29,377	-38,530	-43,246	-50,525
B. Taxing Real Economic Income					
Index capital gains, repeal exclusion					
Individual	4	22	463	6,411	-5,579
Corporate	-532	-1,302	-2,052	594	1,836
Economic depreciation (inflation adjusted)					
Individual	713	2,945	6,141	9,706	12,872
Corporate	5,989	18,942	35,618	51,881	68,055
Repeal investment tax credit					
Individual	1,519	4,319	5,043	5,696	6,246
Corporate	12,993	23,510	26,582	29,169	31,650
Repeal collapsible corporation rules					
Corporate	--	--	--	--	--
Allow expensing of first $5,000 of depreciable business property, repeal scheduled increases					
Individual	--	--	77	184	173
Corporate	--	--	132	220	215
Allow indexed FIFO, repeal conformity					
Individual	-91	-283	-289	-282	-277
Corporate	-3,062	-5,962	-6,008	-5,881	-5,767
Index interest receipts and payments					
Individual	--	--	-1,440	-12,814	-12,974
Corporate	--	--	-3,340	-5,703	-6,246
Taxing real economic income, subtotal:					
Individual	2,145	7,003	9,995	8,901	461
Corporate	15,388	35,188	50,932	70,280	89,743
C. Retirement Saving					
Increase IRA limit to $2,500, equalize spousal IRA limit					
Individual	-1,010	-2,764	-3,005	-3,279	-3,618
Uniform distribution requirements					
Individual	*	*	*	*	*
Excise	--	*	*	*	*
Tax on pre-retirement distributions, uniform basis recovery rules					
Individual	-64	-135	61	300	587

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
Tax on qualified plan reversions					
Corporate	29	20	20	20	20
Repeal 10 year averaging of lump sum distributions					
Individual	-4	50	134	227	329
Repeal 3 year basis recovery rule for contributory plans					
Individual	742	2,058	2,651	2,669	2,688
Eliminate deferral of appreciation on employer retirement securities					
Individual	50	79	85	92	100
Simplify contribution deduction limits					
Individual	20	55	60	67	74
Excise tax on excess retirement contributions					
Individual	*	*	1	1	2
Excise	--	*	*	*	*
Repeal combined plan limit for non-topheavy plans					
Individual	-89	-248	-276	-310	-347
Tax on retirement distributions in excess of ceiling					
Individual	14	15	16	17	17
Repeal ESOP credit, modify deduction limits					
Individual	*	*	*	*	*
Corporate	1,062	2,113	1,371	550	345
Repeal cash and deferred arrangements					
Individual	603	863	936	1,035	1,154
Retirement saving, subtotal:					
Individual	262	-27	662	819	985
Corporate	1,091	2,133	1,391	570	365
Excise	--	*	*	*	*
D. Neutrality Toward the Form of Business Organization					
Dividend relief					
Individual	--	181	1,526	4,540	7,362
Corporate	--	-9,803	-20,678	-28,983	-38,238
Repeal dividend exclusion					
Individual	191	581	604	627	653
Tax all limited partnerships with more than 35 partners at corporate rates					
Individual	174	453	268	151	76
Corporate	142	232	223	215	207
Neutrality toward business organization, subtotal:					
Individual	365	1,215	2,398	5,318	8,091
Corporate	142	-9,571	-20,455	-28,768	-38,031

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
INDUSTRY SPECIFIC SUBSIDIES, TAX SHELTERS, AND OTHER TAX ISSUES					
A. Other General Issues of Income Measurement					
Match expense and income from multiperiod construction					
Individual	142	716	160	1,836	1,965
Corporate	1,871	5,111	8,790	11,881	13,863
Restrict use of cash accounting method					
Individual	61	184	184	184	184
Corporate	357	594	594	594	594
Limit bad debt deductions to actual loss					
Individual	21	64	67	70	72
Corporate	664	1,129	1,187	1,239	1,257
Limit installment sales treatment					
Individual	140	439	497	563	639
Corporate	98	176	200	227	257
Repeal corporate minium tax					
Corporate	--	--	--	--	--
Income measurement, subtotal:					
Individual	364	1,403	908	2,653	2,860
Corporate	2,990	7,010	10,771	13,941	15,971
B. Subsidies for Specific Industries					
Energy Subsidies:					
Repeal business energy credits					
Individual	-45	-69	-73	-78	-84
Corporate	-151	-260	-274	-287	-283
Excise	213	323	345	369	393
Repeal percentage depletion					
Individual	530	1,226	1,301	1,375	1,430
Corporate	834	1,209	1,332	1,453	1,548
Index basis of certain depletable assets					
Individual	--	-8	-32	-61	-88
Corporate	--	-58	-178	-310	-427
Repeal expensing of intangible drilling costs					
Individual	651	1,605	1,264	1,043	1,014
Corporate	4,760	6,979	5,439	4,729	4,620
Repeal expensing of tertiary injectant expenses					
Individual	--	--	--	--	--
Corporate	21	57	93	132	174
Repeal expensing of hard mineral exploration and development costs					
Individual	--	--	--	--	--
Corporate	*	*	43	73	79
Repeal special treatment of royalty income					
Individual	36	99	106	112	119
Corporate	5	9	9	10	10

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
Repeal special rules for mining reclamation reserves					
Individual..	7	22	25	27	30
Corporate..	22	39	43	47	52
Accelerate phase-out of Windfall Profit Tax					
Individual..	--	--	16	71	148
Corporate..	--	--	167	620	1,118
Excise..	--	--	-476	-2,106	-3,482
Energy, subtotal:					
Individual..	1,179	2,875	2,607	2,489	2,569
Corporate..	5,491	7,975	6,674	6,467	6,891
Excise..	213	323	-131	-1,737	-3,089
Financial Institutions:					
Repeal depository institution's bad debt reserve deductions					
Corporate..	996	1,750	1,687	1,669	1,775
Disallow interest incurred to carry tax exempts 5/					
Individual..	-1,118	-4,165	-5,302	-4,019	-4,330
Corporate..	1,880	5,127	5,046	4,297	4,630
Repeal tax exemption of credit unions					
Corporate..	120	212	233	257	282
Repeal merger and carryover rules					
Corporate..	3	4	4	4	4
Limit life insurance reserve deductions					
Corporate..	379	658	704	753	806
Repeal special percentage of taxable income deduction for life insurance companies					
Corporate..	521	907	974	1,046	1,121
Repeal tax exemption of certain life insurance companies					
Corporate..	129	224	240	257	275
Limit P&C reserves					
Corporate..	1,807	3,070	3,169	3,276	3,391
Repeal P&C insurance company deduction for addition to protection against loss accounts					
Corporate..	94	139	111	83	53
Limit deductibility of P&C dividends					
Corporate..	63	108	114	119	125
Repeal special tax exemption, rate reductions, and deductions of small mutual P&C companies					
Corporate..	16	28	30	32	34
Financial institutions, subtotal:					
Individual..	-1,118	-4,165	-5,302	-4,019	-4,330
Corporate..	6,008	12,227	12,312	11,793	12,496
Insurance Investment Income:					
Repeal exclusion of inside buildup					
Individual..	1,296	3,951	3,627	2,779	2,959
Treat loans as coming first from tax exempt buildup					
Individual..	*	*	*	*	*

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
Repeal exclusion of current annuity income					
Individual	619	1,889	1,734	1,329	1,415
Insurance investment income, subtotal:					
Individual	1,915	5,840	5,361	4,108	4,374
State and Local Government Debt and Investments:					
Repeal exemption for private purpose bonds					
Individual	133	589	916	1,132	1,297
Corporate	413	1,303	1,574	1,858	2,157
Tighten restrictions on tax exempt bond arbitrage					
Individual	27	70	64	57	54
Corporate	87	139	127	114	111
State and local government, subtotal:					
Individual	160	659	980	1,189	1,351
Corporate	500	1,442	1,701	1,972	2,268
Special Expensing and Amortization Rules:					
Repeal expensing of conservation expenditures and farmers fertilizer and field clearing					
Individual	283	631	197	204	212
Corporate	297	266	116	120	125
Repeal 5 year amortization of expenditures for rehabilitation of low income rental housing					
Individual	1	3	6	7	8
Corporate	1	5	10	12	13
Repeal 5 year amortization of pollution control					
Corporate	*	*	*	*	*
Repeal 50 year amortization of railroad tunnels and bores					
Corporate	*	*	*	*	*
Repeal 5 year amortization of trademark expenses					
Individual	3	8	14	20	26
Corporate	1	4	7	10	14
Repeal 84 month amortization, 10% credit for reforestation					
Individual	*	*	*	*	*
Corporate	*	*	*	*	*
Special expensing and amortization, subtotal:					
Individual	287	642	217	231	246
Corporate	299	275	133	142	152
Other Specific Subsidies:					
Repeal rehabilitation tax credits					
Individual	80	346	876	1,595	2,069
Corporate	44	143	339	521	623
Tighten rules for depreciating leasehold improvements					
Corporate	*	*	*	*	*
Repeal special rules for returns of magazines etc and qualified discount coupons					
Corporate	161	97	*	*	*

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
Repeal exclusion of Merchant Marine Capital Construction Fund					
Corporate	24	40	45	45	50
Modify credit for research and experimentation					
Individual	-10	-27	-29	-31	-35
Corporate	-577	-1,169	-1,474	-1,710	-1,928
Other subsidies, subtotal:					
Individual	70	319	847	1,564	2,034
Corporate	-348	-889	-1,090	-1,144	-1,255
C. Further Curtailment of Tax Shelters					
Limit interest deductions					
Individual	403	1,385	1,522	1,778	1,843
Limit artificial losses (at risk rules)					
Individual	300	749	609	454	281
Tax shelters, subtotal:					
Individual	703	2,134	2,131	2,232	2,124
D. International Issues					
Use per country limitation for foreign tax credit					
Corporate	900	2,500	2,980	3,278	3,606
Modify rules concerning source of income and allocation of deductions					
Corporate	120	310	400	470	540
Replace secondary dividend rule with branch profit tax					
Corporate	--	10	30	30	30
Replace possessions tax credit with wage credit					
Corporate	--	400	1,000	1,100	1,210
Treat foreign exchange gains or losses as adjustments in interest					
Corporate	10	20	20	20	20
International Issues, subtotal:					
Corporate	1,030	3,240	4,430	4,898	5,406
E. Other Related Tax Issues					
Transfer Taxation:					
Unify estate and gift tax rate structure					
Estate and gift	208	-145	-159	-131	-103
Revise generation skipping tax, modify credit for tax on prior transfers to a lower generation					
Estate and gift	--	*	*	*	*
Prevent abuse of minority discounts					
Estate and gift	--	*	*	*	*
Simplify installment rules based on liquidity, deny deductibility of interest incurred by estate					
Individual	--	-22	-26	-24	*
Estate and gift	--	39	41	10	10

($millions)

	Fiscal Years 1986	1987	1988	1989	1990
Reduce deduction for claims against estate					
Estate and gift..	--	*	*	*	*
Modify state death tax credit					
Estate and gift..	--	--	--	--	--
Repeal special rules for redemption of stock to pay tax					
Individual...	-*	-*	-*	-*	-*
Transfer Taxation, subtotal:					
Individual...	-*	-22	-26	-24	-*
Estate and gift..	208	-106	-118	-121	-93
Penalties:					
Simplify information return penalties					
Individual...	--	--	--	--	--
Corporate..	--	--	--	--	--
Repeal maximum limits for penalties					
Individual...	18	18	19	19	19
Corporate..	3	3	3	3	3
Estate and gift..	*	*	*	*	*
Excise...	*	*	*	*	*
Change failure-to-pay penalty to cost-of-collection charge					
Individual...	290	295	301	307	313
Corporate..	29	31	34	37	39
Estate and gift..	12	12	12	12	12
Excise...	8	8	8	8	8
Penalties, subtotal:					
Individual...	308	313	320	326	332
Corporate..	32	34	37	40	42
Estate and gift..	12	12	12	12	12
Excise...	8	8	8	8	8

($millions)

	Fiscal Years				
	1986	1987	1988	1989	1990
Total Change in Receipts:					
Individual	-22,138	-36,613	-25,209	-25,908	-37,693
Corporate	22,164	30,582	29,341	38,062	44,720
Estate and gift	220	-94	-106	-109	-81
Excise	221	331	-123	-1,729	-3,081
Total	467	-5,794	3,903	10,316	3,865
Current Service Midsession Review Receipts:					
Individual	373,033	407,705	452,438	493,080	537,373
Corporate	87,942	102,718	111,617	116,998	122,638
Estate and gift	5,401	5,036	4,780	4,778	5,127
Excise	36,111	36,785	35,401	34,708	34,028
Total	502,487	552,244	604,236	649,564	699,166
Proposed Law Receipts:					
Individual	350,895	371,092	427,229	467,172	499,680
Corporate	110,106	133,300	140,958	155,060	167,358
Estate and gift	5,621	4,942	4,674	4,669	5,046
Excise	36,332	37,116	35,278	32,979	30,947
Total	502,954	546,450	608,139	659,880	703,031

Office of the Secretary of the Treasury
Office of Tax Analysis

November 25, 1984

* - negligible
1/ Individual unless otherwise noted.
2/ Included in individual rate schedule estimate.
3/ The effect of repeal of these provisions is assumed to be offset by increased expenditures. The receipts generated by these provisions are not shown in this table.
4/ Included in tax preference provisions.
5/ The proposal would effectively eliminate the use of deposits by banks for leveraged holdings of tax exempt bonds. These bonds would then be held primarily by individuals.

Note A: The estimates are based on the Midsession Review of the 1985 Budget. The effects of the reduced corporate and individual rates are estimated assuming all other provisions are enacted. The revenue effects of all other provisions reflect current law tax rates.

Note B: The individual rate schedule estimate assumes that the relationship between collections and tax liability is unchanged from current law. The 1986 level revenue effect may be significantly altered depending on the prescribed changes in the withholding tables and the estimated tax rules.

APPENDIX C

SUMMARY INTERNATIONAL COMPARISONS

The attached tables summarize some highlights of the tax systems of several major U.S. trading partners.

The tables should be read with caution, as many of the features which determine the impact or burden of a tax cannot be accurately presented in such a summary form. For example, it requires a great deal of information to define the base of an income tax; but without doing so, little can be learned from a comparison of tax rates. Even if one could measure the base and rate for a selected pattern of income and deductions, it is difficult to select income levels which represent comparable living standards in different countries and lines of activity.

For such reasons, the tables select certain aspects of foreign tax systems which can be more easily compared in a summary fashion, seeking to minimize both complex qualifications and inaccuracy. The foreign countries included in the comparison are France, Germany, the Netherlands, Sweden, the United Kingdom, Japan and Canada.

Level and Composition of Taxes

Part I of the table illustrates the share of tax revenues in total domestic production in the respective countries and the extent to which each country relies on different types of taxes.

The figures shown include taxes imposed at all levels of government. Part I shows that the share of tax revenues in domestic production varies substantially among the countries compared. Japan and the United States are at the lower end of the scale with ratios of 27 and 30 percent, respectively. In Canada, Germany, and the United Kingdom, the ratios fall between 35 and 40 percent. And in France, the Netherlands, and Sweden the ratios are roughly 45 to 50 percent.

The composition of tax revenues varies even more markedly. Japan, with the lowest ratio of taxes to output, relies more heavily than any of the other countries on the corporate income tax as a source of tax revenues. Corporate income taxes account for 20 percent of total tax revenues in Japan, compared to only 3 percent in Sweden, which has the highest ratio of taxes to output. Total income taxes (not including social security taxes) account for about 45 percent of tax revenues in the United States, Japan, Canada, and Sweden; but except in Japan, 36 to 40 percent of the total are individual income taxes with corporate income taxes contributing only 3 to 8 percent.

France relies relatively little on income taxation. Social security taxes and sales taxes account for more than 75 percent of total

French tax revenues. Social security taxes are also particularly high in Germany and the Netherlands.

Sales taxes are more important in all of the other countries than in the United States or Japan. However, even if sales taxes were ignored, only in Canada would the tax/output ratio fall below that in the United States; the other countries which have higher ratios than the United States would continue to do so. This suggests that sales taxes are often an additional source of revenue rather than a substitute for other taxes.

Individual Income Taxes

Part II summarizes some features of individual income taxes. Unlike Part I, it describes only national level taxes. Part II shows that the marginal rates of individual income tax in the United States are relatively low under current law and the top rate will be even lower under a proposed broad-based income tax. Recognizing that nominal rates of tax can present a misleading picture, section B indicates the average tax rate of a "typical" taxpayer in each of the countries, based on 1982 data. The typical taxpayer is defined as the taxpayer with the median income level for that country at that time. The U.S. tax burden ranks 4th in the group of seven countries, with an average tax rate that is higher than that in three of the other countries, but lower than that in the other four.

Five of the seven foreign countries surveyed provide some inflation adjustment for the tax threshold and bracket rates in the personal income tax. Beginning in 1985, the United States will be in line with that practice as well.

Corporate Income Tax

As shown in Part III, five of the seven countries provide tax relief for dividends paid from income that is subject to tax at the corporate level. The proposed U.S. system will also bring our practice into line with other countries on this point.

Part III also summarizes corporate tax rates at the national level and provisions for capital cost recovery. The proposed reduction in the U.S. corporate tax rate will bring that rate below that in any of the other seven countries. (Sweden also has a low national rate but imposes a substantial local corporate income tax.)

The proposed U.S. system will provide more protection against inflation-induced mismeasurement of income than that of our other trading partners. Our treatment of capital cost recovery in general will be more in line with the practice of other countries, with respect to both equipment and structures, under the proposed system than it is under present law.

Part III further illustrates that the proposed adoption of a per-country limitation on the foreign tax credit would be consistent with the typical practice of other countries that employ a foreign tax credit.

Sales Taxes

Finally, Part IV of the table gives some details on the rates and bases of value added taxes imposed in the five European countries considered. The United States, Canada and Japan do not have a national value added tax. However, Canada imposes a Federal general sales tax at the manufacturers' level, and there are provincial sales taxes at the retail level. Many U.S. states also impose general sales taxes.

The table does not attempt to give a comprehensive picture of the scope of value added taxes, but simply points out that, even within the European Economic Community, it has been difficult to standardize the treatment of different transactions.

Table C-1

SUMMARY COMPARISON OF SELECTED ASPECTS OF DIFFERENT COUNTRIES' TAX SYSTEMS

I. Types of Taxes as a Percent of Gross Domestic Product and of Total Tax Revenues, 1982 a/

	U.S. current law	France	Germany	The Netherlands	Sweden	United Kingdom	Japan	Canada
A. As percent of GDP								
Total tax revenues	30.5	43.7	37.3	45.5	50.3	39.6	27.2	34.8
Individual income tax	11.5	5.6	10.8	10.9	20.5	11.2	6.9	12.4
Corporate income tax	2.1	2.2	1.9	3.1	1.7	3.8	5.4	2.8
Social Security taxes	8.4	19.8	13.5	18.9	15.3	8.0	8.3	3.9
employee share b/	4.2	6.2	6.3	10.9	0.6	3.1	4.1	1.4
employer share	4.2	12.6	7.2	8.0	13.4	3.6	4.2	2.5
Property taxes	3.1	1.6	1.2	1.6	0.5	5.0	2.4	3.1
Sales & excise taxes	5.3	13.0	9.9	10.8	12.2	11.5	4.2	12.1
Other taxes	---	1.4	*	0.1	0.1	*	0.1	0.5
B. As percent of total taxes								
Total tax revenues	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Individual income tax	37.8	12.9	28.9	23.9	40.8	28.4	25.3	35.6
Corporate income tax	7.0	5.1	5.1	6.8	3.3	9.6	19.7	8.2
Social Security taxes	27.7	45.4	36.2	41.6	30.5	20.2	30.4	11.3
employee share b	13.8	14.4	16.8	24.0	1.1	7.9	15.0	4.1
employer share	13.8	28.8	19.4	17.6	26.8	9.0	15.4	7.2
Property taxes	10.1	3.7	3.3	3.6	1.0	12.7	8.9	9.0
Sales & excise taxes	17.4	29.7	26.5	23.8	24.2	29.0	15.4	34.6
Other taxes	---	3.2	*	0.3	0.2	0.1	0.3	1.3

* Less than 0.1 percent.
a/ Includes all levels of government.
b/ Includes taxes of self-employed.

Source: Organization for Economic Development and Cooperation, Revenue Statistics of Member Countries, 1965-83, (Paris France), 1984.

SUMMARY COMPARISON OF SELECTED ASPECTS OF DIFFERENT COUNTRIES' TAX SYSTEMS
(continued)

II. Individual Taxation

	United States current law	United States broad-based	France	Germany	The Netherlands	Sweden	United Kingdom (1986)	Japan	Canada
A. Marginal tax rates (national)	11%-50%[a]	15-35%[a]	5%-65%	22%-56%	16%-72%	6%-52%[b]	30%-60%	10.5%-70%	6%-34%[d]
B. Average tax rate of median income taxpayer in 1982[e]									
single	13.8%1	10.7%[g]	0.8%	15.9%	10.3%	30.0%	21.5%	9.6%	14.9%
married[f]	7.0%	4.5%	---	9.2%	8.0%	27.0%	16.8%	1.4%	-0.4%
C. Indexation	Brackets, zero bracket amount and exemptions (1985)	Same	Brackets	No	Brackets	Brackets allowances, adjusted yearly	Brackets,	No	Brackets, personal exemptions, certain deductions
D. Capital Gains									
occasional sales of portfolio securities	40% of net gain taxable	Taxable; basis indexed	Exempt	Exempt	Exempt	Under two years fully taxed; over two years, 40% taxed	30% of gain above indexed exempt amount; basis indexed	Exempt	Generally 50% of net gain taxable; for certain Investment Plans, 12.5% of accrued indexed gain.
sale of principal residence	Deferred; $125,000 exemption if seller over age 55	Same	Exempt	Exempt if held more than 2 years	Exempt	Taxable with reliefs	Exempt	Exempt up to 30 m. yen (approx. $125,000)	Exempt
E. Wealth tax	No	No	Yes	Yes	Yes	Yes	No	No	No
F. General sales tax	No[h]	No[h]	VAT[i]	VAT[i]	VAT[i]	VAT[i]	VAT[i]	No	Yes[j]

a. Does not include state taxes which, where applicable, range from 0.5 to 16%. A few cities also impose income taxes at rates of 0.6-4.3%. These taxes are deductible from the Federal tax base under existing law but not under the proposed broad-based tax.
b. Does not include local tax, estimated at 30%, which is deductible from the national tax base.
c. Does not include prefecture inhabitants tax which applies at 2 or 4% and municipal inhabitants tax at 2.5 to 14 percent, which are not deductible from the national tax base.
d. Does not include surcharges for provincial income tax (48% in Ontario).
e. Compiled by the OECD from national statistics. Income taxes only; does not include social security taxes.
f. Married taxpayer, two children, one wage-earner.
g. Since the 1982 data do not include the full effect of the tax cuts enacted in 1981, a better comparison between the two U.S. set of rates may be obtained by noting that if the current law rules had continued in effect, in 1986 the average tax of the median income taxpayer would have been 11.4% for a single taxpayer and 6.4% for a married taxpayer with two children.
h. However, most states impose sales taxes at the retail or manufacturers' level.
i. Value added tax. For details, see part IV.
j. Imposed at the manufacturers' or importers' level. In addition, most provinces imposes retail sales taxes.

SUMMARY COMPARISON OF SELECTED ASPECTS OF DIFFERENT COUNTRIES' TAX SYSTEMS
(continued)

III. Corporate income tax	U.S. (1984)	U.S. (proposed)	France	Germany	the Netherlands	Sweden	the United Kingdom '86	Japan	Canada
A. National tax rate	46[a]	33[a]	50	56[b]	43	32[c]	35	43.3/33.3[d]	46[e]
B. Dividend relief to shareholders									
credit or reduced rate	No	Reduced rate[f]	Credit	Both	No	No	Credit	Both	Credit
percentage of double tax relieved	0	50%	50%[g]	100%[h]	0	0	80%[i]	38%[j]	40%[k]
C. Indexing									
depreciable assets	No[l]	Yes	Occasional revaluation	No[l]	Yes[l]	No	No	No	No
inventory	No[l]	Yes		No[l]	No[l]	No	No	Yes[m]	Yes[n]
liabilities	No	Interest[o]	No	No	No	No	No	No	No
D. Sample depreciation calculation									
Equipment									
first year	14.24[p]		35%	30%	Negotiated	30%	25%	25%	50%
years 1-3	55.1[p]		72.5%	65.7%		51%	57.8%	57.8%	100%
write-off period	5 years		q	q		q	q	q	--
investment credit	10%	No	No	No	12%	No	No	No	15.7%
present value, depreciation and credit, as % of investment expense[r]									
6% inflation	100%	76%	78%	75%	N.A.	75%	71%	71%	129%[s]
4% inflation	103%	76%	81%	79%		79%	76%	76%	130%
Structures									
first year	9%		12.5%	2.5%	Negotiated	3%	4%	2.3%	5.0%
years 1-3	26%		33.0%	7.5%		9%	11.5%	6.9%	14.3%
write-off period	18 years		o	40 years		33 years	o	44 years	o
investment credit	No	No	No	No	No	No	No	No	No
present value, depreciation and investment expense[p]									
6% inflation	54	42	56	25	N.A.	30	29	23	33
4% inflation	59	42	61	30		36	33	28	38
E. Treatment of foreign income and taxes[t]									
exemption	No	No	Generally[u]	No	Generally[u]	No	No	No	No
credit	Overall	Per-country	No	Per-country	No	Per-country	Per-country and item	Overall	Per-country
deduction	Election[v]	Election[v]	Yes	Election[v]	Yes	Election[v]	Election[v]	Election[v]	Election[v]

N.A. Not available.
a. State income taxes range from 0 to 12%. Some local income taxes also apply, typically at 1 or 2 percent, but at 9 percent in New York City. The state and local taxes are deductible from the Federal tax base.
b. A 36 percent tax imposed on distributed profits is creditable to shareholders. There is also a local tax of about 15 percent which is deductible from the national tax base.
c. There is a 30 percent local tax, deductible from the national tax base.
d. The lower rate applies on distributed profits. There are also a prefectural inhabitants tax and a local inhabitants tax (5% and 12.3%, respectively, of the national tax) and a prefectural enterprise tax of 12 percent of taxable income. Only the latter is deductible from the national tax base.
e. There are also provincial taxes of about 10-15 percent of which 10 percentage points is credited against the Federal tax. The Federal tax shown is not reduced by that credit.
f. Corporations will be permitted to deduct a portion (50% when fully phased in) of the dividends they distribute out of taxed profits.
g. 25 percentage points of the corporate tax (= 1/2 of the dividend received) is added to the taxable income of the shareholder, who claims a refundable credit of the same amount.
h. The 36% percent tax on distributed profits (= 56.25% of the dividend received) is added to the taxable income of the shareholder, who claims a refundable credit of the same amount.
i. 27.86 points of the corporate tax (= 3/7 of the dividend received) is added to the taxable income of the shareholder, who claims a refundable credit of the same amount.
j. The taxpayer claims a credit equal to 10 percent of the dividend received. The credit is not added to taxable income.
k. 18.36 points of the corporate tax (= 34% of the dividend received) is added to the taxable income of the shareholder, who claims a non-refundable credit of the same amount.
l. However, LIFO (last in-first out) valuation of inventories may be used. In the United States, if LIFO is used for tax purposes it must also be used for book purposes.
m. 2.5% of the book value of certain inventories and securities may be allocated to a special reserve fund against price rises, and LIFO may be used to value inventories.
n. An annual 3% inventory write-off is allowed.
o. Inflation premium excluded from interest receipts and payments.
p. Includes effect of basis adjustment for one half of investment tax credit.
q. Declining balance ("open accounts") method used; write-off period not defined.
r. Assumes 4 percent real interest; considers equity investment only.
s. Investment credit translated into a deduction at a 46 percent corporate rate.
t. Statutory rules; may be modified in tax treaties. Similar rules apply with respect to foreign income and taxes of individuals.
u. Business income is generally exempt from tax; passive investment income is generally taxable with a deduction for foreign taxes paid.
v. Taxpayers may elect to deduct otherwise creditable foreign income taxes paid. In general, the election applies to all creditable foreign taxes paid or accrued that year.

SUMMARY COMPARISON OF SELECTED ASPECTS OF DIFFERENT COUNTRIES' TAX SYSTEMS
(continued)

IV. Value added taxes: rates and principal exemptions

	France	Germany	The Netherlands	Sweden	United Kingdom
A. Rates (percent)					
Basic rate	18.6	14	19	23.46	15
Higher rates	33.3	--	--	--	--
Lower rates	7, 5.5	6.5	5	12.87, 3.95	--
B. Principal exemptions[a]					
Exports	Yes	Yes	Yes	Yes	Yes
Real property Transfers	Some	Yes	Yes	Yes	Yes
Financial transactions	Most	Yes	Yes	Yes	Yes
Transfers of a business	---	Yes	Yes	Yes	Yes
Professional services	Many	---	---	---	---
Communications	---	---	Yes	---	---
Construction	---	---	---	---	Yes
Periodicals	---	---	---	Yes	---
Medicine	---	---	5%	Yes	Yes
Food	5.5%	6.5%	5%	---	Yes
Books	7.0%	6.5%	5%	---	Yes
Fuel	---	---	---	Yes	Yes
Transportation	7.0%	---	---	---	---

a. Some of the transactions classified as exempt may be taxable at a zero rate. The difference is that an exemption does not necessarily give rise to a refund of tax paid at prior stages, whereas a zero rate does carry a full credit. Exports, for example, are taxed at a zero rate with a refund of tax previously paid.

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